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Implementing Employee Ownership in the Jordan IT Industry
ESOPs

Draft Report

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Executive Summary:

The benefits of employee ownership have been recognized in the Jordanian IT industry just as they have in other countries and companies around the world. The best practices for implementing the means of converting employees to stockholders and motivating them to think and act like owners are varied.

The different plans for sharing stock with employees are categorized as either performance based or broad based. Performance based plans are those which are based on the performance of individual employees. These include stock options, stock bonuses, and direct stock purchase offers. The benefit of performance based plans is that they can be tailored to motivate selected individual employees.

Broad based plans are those which provide stock to a broad base of employees without regard to individual performance. These plans include company wide stock purchase plans and traditional Employee Stock Ownership Plans (“ESOP's”). The benefit of broad based plans is that they put company stock in the hands of many if not all of a company's employees and therefore give everyone the feeling that they are employee owners. The detriment is that they are expensive to initiate and maintain because of the large number of participants.

Vesting is a condition tied to stock based awards which prevents the employee from receiving part or all of an award unless certain performance or employment goals are met. Vesting provides the company with "glue" or "golden handcuffs" to discourage productive employees from voluntarily leaving the company.

Communication is a major part of developing an employee ownership culture. The goal is to make employees part owners of their employer company so they think and act like owners. To do this they need to receive and understand periodic information on the company, the stock they own in it, and on how their performance has affected the

company. Providing this information is a significant task, the importance of which cannot be ignored.

Employee owned companies which are not publicly traded face the issue of "repurchase liability" which arises out of the obligation of the company to repurchase the stock owned by terminating employees at its fair market value. The amount of this liability can be substantial and must be provided for by either prefunding it or by other means.

Other issues which must be considered in adapting a plan to share equity with employees are stock liquidity, restrictions on the transfer of shares, valuation, and others, all of which are described and addressed by two companies described in Appendices C and D. In addition, a general description of the means of adapting employee ownership plans which have been utilized in different countries around the world are described in Appendix B.

Many companies have been built upon the principle of employee ownership and have developed this concept and the means of implementing it over years by experimenting with various plans to provide their employees a financial stake in their employer. Two of these companies, both of which are extremely successful and have in place sophisticated employee stock ownership systems. These companies file periodic public reports which describe in layman's language every material aspect of their companies and the employee ownership plans. These public fillings are attached to this report as Exhibits C and D and can reviewed by interested parties as examples of the best practices for implementing successful employee ownership plans.

The means of adapting these best practices in employee ownership in Jordan is to have int@j, the Jordanian IT industry association, assume responsibility for promoting the necessary legislative changes authorizing employee ownership plans, such as those discussed above, to be instituted in Jordan. Int@j should also take other action to promote employee ownership in the IT industry by developing informational literature, acting as an administrator for employee stock plans, and other proactive means of pursuing the good of employee ownership in the IT sector.

To prepare this report, the author reviewed various laws and documents and discussed the issues of employee ownership and its desirability in the Jordanian IT Industry with numerous individuals. In addition, he had extensive interviews with officers of four Jordanian IT companies and three Jordanian law firms. Finally, the author gave a presentation on the use of employee ownership to increase the competitiveness of the Jordanian IT industry which was attended by approximately 75 individuals. The focus of their comments and questions was not whether equity compensation should be offered but, rather, when and how it can best be implemented.

During the interviews and presentation the author discussed and explained how employee ownership is implemented and maintained. In addition, the ancillary obligations imposed upon the employer and employees adapting an equity sharing plan were discussed in detail. The overall message gathered from these sources was that the Jordanian IT industry needs to be able to implement equity sharing in their companies to stay competitive in the world labor market.

Unfortunately, under the current laws and practices of Jordan this is not possible. Jordan's corporate laws do not provide local companies with the flexibility needed to institute the plans described in this report. Today in Jordan local companies take circuitous means to share their stock with their employees including incorporating in the United States and entering into secret buy-sell agreements between company directors and employees. In addition to uncertain laws, Jordanian government officials who interpret these laws do so inconsistently. As a result, the corporate laws of Jordan should be modified to provide the flexibility and certainty needed to institute the employee ownership plans desired by the IT industry.

The recommend legislative changes are those necessary to allow the IT industry to adapt and operate benefit plans which will give their employees an ownership interest in their employer through the best practice methods described in the first part of this report.

Due to the urgent need to adapt some form of equity sharing in the immediate future, it is recommended that int@j act to obtain approval of a form Providence Plan which can be used to share a company's stock with its employees. In the near future int@j should attempt to obtain approval of other means to institute employee stock ownership such as stock options and stock purchase plans. It is proposed that the approval from the government for these plans be obtained as "safe harbors", i.e. form plans with defined parameters within which companies are free to design and adapt their own specific plans with assured government approval.

In the long term, int@j should work on promoting legislative changes of laws which prohibit the adaptation of the plans discussed above.

In conclusion, employee ownership is a powerful tool for recruiting, motivating, and retaining quality employees and is necessary if today's Jordanian IT industry is to stay competitive.

<u>The basis of this Report:</u>

This report was prepared based, in part, upon a review of the following documents and a series of interviews described below:

> The Jordan Income Tax Law, Number 57 of 1985 as amended by Law 14 of 1995
>
> The Jordan Companies Act of 1997
>
> The Jordan Securities law of 1997
>
> The Reach Initiative
>
> The Amir Web pages

<u>Section I. A Description of Best Practices in Employee Ownership and their development in Jordan.</u>

The desirability of enabling employee ownership in the Jordanian IT industry has been recognized just as it has in other industries and countries around the world.[1] As stated by the worlds leading employee owned technology company, "We believe our employee-ownership concept enables us to recruit and retain top performers, motivate our

[1] See Appendix B for a survey of employee ownership plans around the world.

employees and reward their achievements."[2] The practices and means of allowing employees to participate in the equity of their employers is as common as it is diverse. The following describes some of the methods for implementing employee ownership, the resulting problems which commonly arise, and some suggested solutions:

Means of Incorporating Employee Ownership into the Jordanian companies:

There are a number of different methods for sharing stock with employees, each of which can help a company meet various business objectives. The two most basic approaches for sharing ownership are performance based and broad based plans.

Performance Based Ownership Plans

Performance based ownership plans offer great flexibility, including the ability to tie rewards to individual performance and allow owners and executives to offer different levels of stock awards to any and all employees. There are three types of performance based plans: stock options, stock bonuses and direct stock purchase offers.

Stock Options: Stock options give an employee the right to purchase a number of shares of stock at some time in the future at a fixed price; the stock price is typically set at the price of the stock on the date the option is issued. For example, an employee may be granted the option to purchase 1,000 shares of stock at today's fair market value of $1 per share. The option grant specifies an expiration date, which means the employee must exercise the option by purchasing the shares before that date or forfeit the options. Options typically vest over a period of time which, as explained below, means the employee must stay with the company or meet specific performance objectives before receiving the right to purchase some or all of the optioned shares.

Stock Bonuses: A stock bonus is an award of a number of shares of stock to an employee. A stock bonus may be offered to get stock into the hands of employees who would otherwise be unable or unwilling to purchase the stock with their own money. It may also be offered in lieu of a cash bonus which could save the company cash during its early stages. A vesting stock bonus requires an employee to stay with the company for a period of time or meet performance objectives before receiving the right to the value of the shares. An unrestricted stock bonus does not require that any conditions be met before gaining the full value of award, but they are rarely given and are not recommended.

Direct Stock Purchase Offers: A direct stock purchase offer gives an employee the right to purchase a number of shares of stock at a given price. These plans are most popular in companies which have an established history of earrings and stock price increases to the extant that owning the stock becomes almost a privilege. T encourage and facilitate such purchases, the company may make a loan to employees, allowing them to pay for the purchase over time. The company may also discount the purchase price or offer a matching stock bonus or option award to encourage stock purchases by employees.

Broad Based Ownership Plans

Broad based ownership plans allow the company to share ownership with all employees thereby creating a culture that allows all employees to think and act like owners. Broad

[2] SAIC 1999 prospectus, attached hereto as Appendix C.

based plans are not as flexible as performance based plans but usually offer greater benefits to all employees thus promoting a true "employee owned company" mentality. There are two general types of broad based plans: stock purchase plans and employee stock ownership plans.

Stock Purchase Plans: Stock purchase plans are set up to allow a broad based group of employees to purchase company stock and to give employees an incentive to invest in their company. Most plans are structured to allow employees to purchase stock at small discounts. In order to make it simple for employees to participate in the plan, the purchase price is often deducted from employee paychecks and held by the company to purchase stock on specific dates.

Employee Stock Ownership Plans (“ESOP”) An ESOP is a plan into which the company makes periodic contributions on behalf of the employees. In the US, the corporation receives a tax deduction based on the value of the contributions made and the employee is not taxed on the value of his or her retirement account until the funds are distributed to the employee. The company contributions are invested primarily in company stock and then allocated to employee accounts based on a pre-determined formula, typically an percentage of pay. Employees’ accounts grow each year based on company contributions and investment growth on the account balance, and then will be paid out to the employee usually upon retirement or termination of employment.

Employee contributions to employee ownership programs

The concept of permitting individual members to contribute to the employee ownership programs is, in itself, justifiable. Employees who contribute their own funds to acquire their interest are more inclined to act like owners. Employees who invest in employer stock do not look upon their investment as just another entitlement of working. They view it as something they worked and paid for. Studies have shown that stock purchased by an employee is more meaningful to employees when they put some of their hard earned cash on the table in purchasing stock. Entrepreneurs who offer stock purchases often find that employee investors take a more active interest in their company and are more likely to act like owners. Therefore permitting employees to purchase stock in the company should seriously be considered. As a result, they are less likely to use it as a source of short term funds. Instead, employees who purchase an interest in their employer will hold on to these shares for the duration of their employment. By contrast, it has been demonstrated that almost 90% of employees of publicly held companies who receive stock options, exercise those options and sell the underlying stock in the same transaction on the same day. As a result, these employees lose their stake in their employer after the excise of their options.

Used wisely and not excessively, allowing individual members to pay for employer securities is a viable strategy to promote employee ownership within a company.

Mandatory contributions: Needless to say, it is neither motivating, inspiring, nor welcomed to require employees to make significant financial contributions to their employer to participate in employee ownership programs. The ramifications of having the employees lose their out of pocket payments is significant. News of such an event would spread quickly and undermine the entire employee ownership program and spirit within a company. If an employer does fail, it will not be as significant if all the payments to the program were made by the employer or voluntarily made by the employee with full knowledge and acceptance of the attendant risks. But if the failure causes the employees to lose their own funds they were required to invest, it would be hard for the employee ownership program to regain credibility. Therefore, the employer should never look to its members for mandatory contributions.

Communications between the company and its employees/plan participants

The ultimate purpose of all compensation plans is to communicate company wide goals to employees and reward them for their part in achieving these goals. The hardest part of establishing an incentive compensation system is to structure communication systems to make the employees think like owners instead of employees. Prompting the employees to make this transition is a difficult and time consuming process. It is done through a system of education and communication with the employees which is designed to accomplish several objectives.

First, the communications need to inform employees about employee ownership plans, what they are, how they operate, the benefits of being in them, and the risks involved. To feel like an owner, the employee has to thoroughly understand how the system works and what part the employee's role in it.

Second, employee communications should inform members of their rights and obligations as plan participants. As participants, they have the right to be judged based on established criteria; they have the right to receive additional compensation under the terms of the plan; they have the right to be given information by which the achievement of their goals can be measured, just to name a few. They also have the obligations to meet these criteria, to perform the requirements of their positions, and the obligation to provide feedback to the organization on their view of the operation of the company.

Third, communications are needed to inform employees of the status of the company and the criteria upon which they are evaluated. The communications must also provide information on individual employee account holdings. This information must be communicated in a way to allow employees to understand how their daily work is connected to the company performance. Employees should be able to translate financial information into guidelines relating to their own performance.

The information presented to employees must at a bare minimum accomplish these three objectives. This means that the employees cannot be presented with information which is designed for other purposes such as investor relations or tax assessment.

Employee communication is not an incidental process but a major part of any incentive compensation system. Therefore, it has to be treated as such by both the company and its managers. One or more persons should be assigned to and accountable for providing this communication/education process.

Vesting. Vesting is the amount of time an employee must work before acquiring a non-forfeitable entitlement to the equity benefit. It is a concept that requires the employee to stay with the company for a number of years or meet certain specific goals in order to realize the full economic impact of the award. If the employee does not meet the vesting requirements, part or all of his or her award would be forfeited.

Attaching a vesting schedule to a stock award, either in performance or broad based ownership plans can be a very powerful retention tool. Vesting encourages employees to stay with the company longer therefore encouraging employees to work for the long term benefit of the company. In addition, vesting can help reduce the a company's repurchase liability.

Vesting can be calculated in a number of ways. Vesting can be periodic, where employees earn a portion of their award each year they work. For example, a four year vesting schedule with twenty five percent vesting each year would require the employee to stay with the company for four years in order to receive the full economic value of the award. If the employee leaves the company prior to four years, he would forfeit a portion of the award. In this example, if the employee leaves the company after two years but, before three, he would be allowed to keep the fifty percent of the award and would forfeit the other fifty percent.

You can also calculate vesting using a "cliff" vesting schedule. With cliff vesting the employee earns no vesting credit until the full vesting schedule is satisfied. For example, if the cliff vesting schedule is four years, the employee would be required to stay with the company for four years in order to keep the full value of the award. If the employee leaves the company at any time before four years, he forfeits one hundred percent of the award.

Vesting may also be based on performance goals for the individual employee, some division within the company, or the company itself. For example, a stock award may vest contingent upon the price of the stock reaching a certain price or the sales attributed to the employee reaching certain goals. As soon as these objective goals are met, the stock award vests.

One problem with vesting schedules based on performance is that if it turns out that the employee is a stellar performer and he meets his vesting goals, the company loses all the "glue" it had to keep the employee with the company for an extended period of time.

These are just a few examples of how vesting schedules can be structured. There are an infinite number of ways and permutations of combinations which can be structured by the employer, all based on the needs of each of the parties and environment in which they will operate.

It is recommended that vesting schedules be attached to all employer funded stock benefits.

Employee contributions made on their own behalf are always one hundred percent vested and are never subject to forfeiture.

Repurchase liability

An issue which faces non publicly traded companies who have sold their stock to their employees is the lack of liquidity for their shares. In discussing any aspect of an employee owned company the practical obligation of the company to repurchase shares owned by individuals whose employment terminates should be addressed.

In general, a company must provide a means for employees to receive the value of their shares when their employment is terminated. This obligation is the practical result of the necessity of the company to buy its stock back at that time to prevent it from remaining in the hands of a non employee. Consequently, when an employee terminates, the company has to come up with the funds to pay the employee the fair market value of his shares. This liability is known as “repurchase liability.” It is the liability of company to pay the fair market value of the shares of all departing employee/plan participants. The amount of repurchase liability when calculated, frequently prevents companies from distributing stock to its employees.

There are many factors affecting a company's repurchase liability including i) employee turnover, ii) the number of new employees, iii) salary increases and increased allocations, iv) vesting schedules v) the basis of allocations of shares, vi) whether the value of the shares has increased, vii) the terms of stock valuation viii) retirement age, and ix) whether and under what conditions the employee can rejoin and withdraw from a company.

All of these factors by themselves and interrelated with each other affect the amount and frequency of a company's repurchase liability.

The ability of a company to make its repurchase liability payment in a timely manner depends on: i) whether the company has funded its liabilities, ii) the amount and source of this funding, iii) the ability of the company to obtain other sources of funding, and iv) revenues and expenditures.

It is imperative for companies to fulfill their obligation to make a fair payment to terminated employees within a reasonable period to maintain their credibility within the workforce. It is self defeating for employees to be told of the benefits of employee ownership and then see that their employer is not delivering what it promised.

<u>Miscellaneous issues in employee ownership.</u>

The best practices for managing other issues relating to employee ownership such as restrictions on the transferability of shares including the right of first refusal and the right of repurchase on termination, simulated equity plans including stock appreciation rights and phantom stock, stock value dilution, the means and necessity of providing stock valuation using a formula, stock liquidity, and disclosure requirement under securities laws and general principles of fairness are discussed in detail in Appendices C and D.

<u>Documentation of Other Employee Owned Companies describing best practices.</u>

The benefits of employee ownership have been recognized and developed to the most advanced and sophisticated levels in many large corporations around the world. Information on two of these companies and an evaluation of how they address the many issues arising out to employee ownership provide real world examples of best practices of implementing and operating such plans.

One of these companies is Science Applications International Corporation ("SAIC"). SAIC was founded in 1969 and is a 100% employee owned IT company with 35,000 employees and over $5 billion in annual revenue. It has developed probably the most sophisticated and obviously successful employee ownership systems of any company in the world.

Many of the employee ownership programs discussed here have been in use at SAIC for a number of years. The terms of these plans and a description of them prepared in layman's language understandable by employees is located in the prospectus prepared by the company annually and distributed to employee/stock purchasers to inform them of the nature of the stock they are being offered/purchasing, the attendant risks, and other material information which employees would want to know before purchasing stock in their employer. This prospectus is prepared annually and filed in accordance rules of with the rules of the US Securities and Exchange Commission, an agency of the US Government which regulates the sale and trading of securities.

A copy of the 1999 SAIC prospectus is attached hereto as Appendix C.

The information in this prospectus can be used by int@j and others in Jordan for an example of best practices in employee ownership. The prospectus describes various types of employee ownership plans available and how the terms and conditions of each can vary.

The prospectus also provides examples of the disclosure required to communicate to employees the different attributes of their employee owned company and the individual plans. As discussed in this report, employee communications in an employee owned company is a major undertaking and cannot be underestimated nor under utilized. The SAIC prospectus serves as an example of what a successful employee owned company discloses to its employees about their stock system as <u>part</u> of their obligation to keep their employees informed.[3]

The prospectus further describes other attributes of a successful employee owned company such as the restrictions on the transfer of stock, vesting, control provisions, risk factors of investing, liquidity, formula pricing, and many others. These disclosures are exemplary descriptions of the many facets of a successful employee ownership structure.

Another company, CH2M Hill, is also wholly employee owned company engaged in providing technology and environmental engineering services. It has annual revenues of over $1.3 and employees 8,000 employees around the world. The company's growth rate and profitability have been nothing short of phenomenal. Like SAIC, it is believed that much of CH2M Hill's spectacular success can be attributed to its employee ownership system and the culture it developed among its employees.

CH2M Hill has also filed a prospectus with the US Securities and Exchange Commission which describes all of its stock based employee benefit plans and various aspects of the company. Like the SAIC prospectus, it serves as a complete description of "best practices" in an employee owned company and can also serve as a model and guideline for the Jordanian IT industry.

A copy of the CH2M Hill 1999 prospectus is attached to this report as Appendix D.

Finally, in reviewing best practices, the manner in which companies and governments around the world use employee ownership plans to further there goals should also be considered. Employee ownership systems have been implemented by both individual

[3] The prospectus should not be viewed as fulfilling the employers entire commitment to communicate relevant information with its employees as described in the Section entitled "Communications" herein.

companies and governments around the world in their effort to privatize state owned enterprises. These systems should also be considered in reviewing best practices to learn from the methods which have been successful. In addition, reviewing efforts in implementing employee ownership which have been unsuccessful can also shed light on the viability of alternative employee ownership plans in various environments. To this end, Appendix B contains a brief survey of employee ownership practices in different countries around the globe.

Implementing Employee Ownership In The Jordanian It Industry

Int@j, Information Technology Association-Jordan, the trade association of the Jordanian IT industry should promote employee ownership for the Jordanian IT industry. It must take the lead role in providing support to develop legislation and promote employee ownership in IT companies in Jordan by adding to its agenda the following:

- To act as a lobbying body to promote legislative changes allowing for various forms of employee ownership required by the competitive IT industry.
- To be seen as the primary resource for Jordanian IT companies seeking information on employee ownership;
- To facilitate and support efforts to understand the various forms of employee ownership.
- To help any company become more productive and competitive by emphasizing employee ownership.
- To become a recognized authority on developing policies for employee ownership.
- To act, either itself or through a subsidiary operation, to provide administration of employee ownership plans it promotes.

Int@j will also need to provide support to local IT companies and give them the needed assistance allowing them to become more effective and efficient in managing and administering their employee ownership plans . Support will need to take the form of many efforts including the development of publications, providing individual consulting, establishing a series of workshops and conferences, developing training programs, providing sample legal, organizational and communication documents, establishing a web site and creating other products and services as determined based on a needs assessment conducted with IT companies.

As explained in Section III of this report, int@j should also promote and support the implementation of legislative reforms encouraging the development of employee ownership practices. Even after initial legislation is approved, it is critical that int@j take an active role to both protect efforts by opposing forces to repeal employee ownership and employee ownership legislation, and to develop and promote additional legislation that will benefit employee owned companies. Int@j should also seek to develop a sufficient constituent base to sustain government support for employee ownership.

In addition Inta@j should launch a media, public relations and outreach program which would position and raise the profile of Jordanian IT companies and their employee ownership benefit programs. Int@j needs to develop a concise message and marketing materials and distribute those to media markets throughout Jordan allowing them to spread positive stories about employee ownership to the public.

Finally, int@j should gather and analyze statistical data on the use of employee ownership schemes and benefits in IT companies to support its promotional efforts. A database should be developed allowing the organization to gather appropriate information in the Jordanian IT industry on the different forms of employee ownership, the growth of employee owned companies, the benefits received by employees, the different plan provisions and repurchase liability strategies.

The duties, actions and responsibilities of int@j suggested herein are a realistic and practical approach to adapting the best practices of employee ownership in the Jordanian IT Industry.

Section II. Issues and concerns discovered during the meetings and interviews with members of the Jordanian IT Industry.

To gather information for this report, the author attended two meetings with the IT Development Working Group where observations and conclusions regarding employee ownership were discussed.

In addition the author attended a special stakeholder meeting where he made a presentation to approximately 75 participants in which general issues of employee ownership schemes in the Jordanian IT industry were discussed. During this two hour presentation, individuals asked numerous questions and made various comments relating to the subject matter. An outline of the presentation distributed to all in attendance is attached to this report as Appendix A.

Finally, personal interviews were conducted with following individuals:

> Majied Qasem CEO and the Chief Financial Officer of One World Software
>
> Talal F. Samhouri, MBA of Atlas Investment Group
>
> Hatem Aein, President and CEO and Ihab Saadi, Chief Operations Officer of Zeine Technological Applications
>
> Issam Jallad, Assistant General manager of Idealsoft
>
> Rami Awad, General Manager of Integrant and his four top managers.
>
> Omar N. Nabulsi, attorney at law, head of the Nabulsi & Associates Law firm, and two of his associate attorneys, Jumana A. Toukan and Lana H. Salameh.
>
> At the International Business Legal Associates law firm, the author interviewed and worked with attorneys Wael. M. Wahbeh, Rana Bin Tarif, and Nissreen Haram.

In addition to the above, the author received feedback on the current status of the Jordanian IT Industry and employee ownership from many other individuals he met during his stay.

The details of these interviews will be presented as a summary without attributing statements or positions to any of the parties interviewed. This is done to comply with the request of the parties and promise of the author to maintain the anonymity of their comments.

During all of this interaction the author was never questioned on whether Jordanian IT companies should implement some form of employee ownership system to make them more competitive, but rather how they can do so under present law to stay competitive.

The participants stated repeatedly that to compete for programmers and other IT professionals, they competed against offers from foreign companies which offered the employees equity based incentive compensation which was most frequently stock options.

Many Jordanian IT companies work and compete in the international marketplace. The companies interviewed had offices and operations in Germany, the United States, and China. Their competition was from companies from all over the world. In particular, the Indian company InfoWorld was mentioned as a direct competitor for customers.[4] The interviewees said that they also compete against US companies such as Cisco Systems for qualified help in Jordan. A shortage of experienced qualified IT professionals in Jordan has fueled this competition among IT companies.

Foreign companies routinely offer stock options in their company's stock as part of their compensation package offer. At the present time, under the current Jordanian law, local companies cannot offer comparable equity sharing. The one Jordanian company who is doing so is only able to do so because it incorporated in the United Sates and operates the corporation and issues stock options under US law.

Being able to offer employees the opportunity to share in the growth of their employer is now mandatory in the IT industry world wide. To stay competitive in the market for qualified IT professionals companies must be able to offer this form of incentive in their compensation packages. This is not possible nor practical under current Jordanian Law.

There are several reasons for this. First, companies are formed in Jordan as either limited Liability Companies or Public Shareholder Companies. The latter are designed specifically to become publicly held and the law contains all the necessary provisions to allow them to be held by numerous stockholders and all the other requirements of public ownership.

Limited Liability Companies are however, established as closely held companies with closely held ownership are not designed to be held by more than a few individuals. This law provides none of the flexibility that employee ownership plans described herein require. Unfortunately, most of the IT companies in Jordan were formed and are operating as Limited Liability Companies.[5]

The reason for the distinction between the two types of companies is based upon the government's efforts to create statutory protection to prevent widespread losses to local stockholders which occurred in Jordan several years ago.

[4]InfoWorld it was explained is an Indian Company that went public on the US market and now has a market capitalization of over $1 billion.

[5] Transforming LLC businesses into Public Shareholder Companies is not a practical option as explained in a Report of the Reach 2.0 Capital and Finance Committee dated July 29,2000.

The Jordanian corporate laws do not provide the flexibility necessary for employers to implement equity sharing with their employees. The laws were never designed to give companies that flexibility because when they were drafted equity sharing with employees was not an issue. Now, due to the rapidly changing workplace, equity sharing is not just an issue but a necessity, the Jordanian Corporate Laws have become an obstacle for local IT companies.

The corporate laws should be such to provide the necessary flexibility to allow domestic companies which are bound by the laws to compete in the world market. As they are now written, the Jordanian laws restrict the flexibility of Jordanian Companies and inhibit their ability to compete against companies formed under foreign laws. These restrictions are based on not only what is written in the law but what is not written. The laws are silent on many points and therefore there is uncertainty as to whether they are allowed.

Jordanian law also provides for the review and approval of corporate filings by the Commissioner of Companies on an annual basis. This review is believed to be burdensome and subject to individual discretion of whomever at the Commissioner of Corporation is conducting the review. There are no definitive written standards or guidelines the companies can follow.

One interviewee stated that "Every direction we go to share our company with our employees we find that there is no law in Jordan allowing it or there is government interference preventing it."

Another poignant comment was that the law and the application of the law are different in Jordan. The law may say one thing but it is interpreted by many administrators, each of whom has their own personal, independently developed interpretation of it, all of which may be inconsistent with other administrative interpretations and the law.

Many of the IT companies we talked to stated that they were exempt from Jordan Income Tax because they sold all of their IT products/services outside of Jordan. At least one IT company said they performed all of their services and derived all their revenues within Jordan so they were subject to the full extent of Jordanian Tax law. One issue to be considered in structuring laws to encourage employee ownership is that tax benefits will have no effect on local companies which export their product because they are already tax exempt.

Other interesting comments made related to the tax exempt nature of domestic IT companies who export all their work product. It was felt that the government adapted this tax exempt status provision to attract exporting IT companies to Jordan. But the consensuses was that this tax exemption was not enough to achieve its goal for at least two reasons. First, even though this is clearly the law now, there is no assurance that it will not be changed retroactively, thereby allowing the taxing authorities to demand taxes from these exporting companies for prior years. Second, this tax exempt status does not compensate for the provisions of Jordanian Law which prevent the company from distributing stock to its employees. Consequently the tax issue has to be discounted as not being the sine qua non of operating in Jordan.

Due to the tremendous burden placed on Jordanian companies by the corporate laws, those local companies who now believe in the concept of employee ownership and are actively practicing it, are prevented from operating under Jordanian law. Instead, to circumvent these restrictions, they incorporate their company or a holding company (which holds the stock of the Jordanian operating company) under foreign law which allows them to provide all the forms of stock sharing they desire. This reincorporating in a foreign company is not only necessary to access the flexibility to enact stock based benefit plans, it is also required by outside investors who do not want companies in which they invest governed by Jordanian law.

It was also pointed out that companies who want to issue stock to their employees do so by issuing the stock to their directors who then enter into informal agreements with the employees to sell the stock to them at certain prices on certain terms. This sham mechanism was one of the circuitous routs Jordanian companies had to resort to provide stock to their employees.

Another important fact stressed by interviewees was that many of the most qualified Jordanian IT professionals with 2 to 7 years of experience are currently working in the Gulf States and are routinely recruited to work there. These individuals have told local companies who were trying to recruit them that they would come back to work in Jordan for half of the salaries they are being paid in the Gulf if they could receive some sort of incentive compensation which could “possibly” make up for this difference. The employees said they would much rather work in their home country where they can live at home, be with their families and benefit Jordan if they could otherwise compensate for this salary differential.

Parties interviewed said that the ability to allow employees to share in their equity would allow them to better attract and retain this most sought after segment of the IT workforce and for this reason alone should be allowed.

Section III. Recommendations for Legislative Reform and Proposed Actions.

Under Jordanian laws companies are formed either as Limited Liability Companies or Public Shareholder Companies. Each of these two types of companies have different attributes and are governed by different laws[6]. Public companies are formed with the express purpose of becoming publicly traded. Limited Liability Companies are formed as closely held companies. All of the companies interviewed were formed under as Limited Liability companies. The Limited Liability law does not anticipate nor provide for the sale or transfer of shares to a large number of individuals/employees. In particular, there are provisions in this law which can be interpreted to limit actions such as issuing stock options.

In theory corporate laws[7] are adapted not just to regulate local companies, but also to promote and protect them. At present, the Jordanian laws and the manner they are interpreted and enforced are failing to promote and protect the companies incorporated there under by limiting the flexibility of local companies to develop equity sharing plans. The laws are so restrictive that Jordanian companies are being forced to reincorporate elsewhere to enable them to adapt employee ownership plans. As such, these laws are

[6] Public Shareholder Companies are formed and regulated by Article 99, et. seq. of the Companies Act of 1997 and Limited Liability Companies are formed under Article 53 et. seq. thereof.

[7] As used herein the term “corporate laws” is used in the broadest sense referring to all the laws which regulate the operation of a corporation such as securities, labor, tax and traditional corporate laws.

non productive and should be changed. The current laws contain restrictions which are designed to prevent investors from being defrauded by unscrupulous stock promoters. However, these restrictions, while limiting fraud, also restrict companies who want to operate legitimately.

Moreover, as stated by many of the persons interviewed, it is not just statutory language which prevents the adaptation of such plans, but also the lack of statutes and the inconsistent application and interpretation of the laws.

There are two sides of Jordanian law relating to employee ownership plans. On the one hand the interpretation and application of the law does not allow the implementation of traditional employee ownership systems such as those discussed in Section I of this report. On the other hand, Jordan already has in place many laws which would favor an employee ownership system if such a system could be implemented. Perhaps the most notable one is the tax law which exempts from taxation capital gains, i.e. gains from the sale of stock. In an employee ownership system much of the gain to employees comes from the sale of employers' securities. The fact that the present law allows these sales to be tax free would incentivise employees to take their compensation in the form of employer stock rather than wages and thus avoid the income tax. The only potential issue here is whether the taxing authorities would close this benefit if they believed that it is being taken advantage of.[8]

These are just some of the issues raised relating to the applicability and incompatibility of the laws of Jordan today and the movement to institute employee ownership plans in progressive IT companies. A complete statutory analysis of these corporate, securities, tax, labor and other laws which bear on the ability of Jordanian companies to adapt employee ownership plans such as those described in Section I of this report is an enormous undertaking and is beyond the scope of this report.[9] Moreover, there is an issue whither such a salutatory review would be productive in view of the fact that much of the discord and confusion arises out of the inconsistent interpretations of these laws which are not documented. Consequently, the most productive manner of determining what needs to be changed, if anything, is to obtain a binding determination from the governing agencies clearly defining which plans instituting employee ownership are permissible and which are not. With this issue defined and resolved, it will be known which of the plans outlined in Section I can be implemented now and for those that cannot, the legislative changes which must be made.

It is proposed that int@j spearhead movements to obtain blanket approval of what are commonly referred to as "safe harbor" plan provisions. This term is used to describe the parameters of a plan defined by the government or approving agency within with a company is free to adapt a plan without further government approval. A safe harbor ruling would be in writing, definitive and certain so there would be no ambiguity as to how the law would be applied and interpreted. The concept is that if an employer designs

[8] Many of the interviewees commented that they view the taxing authorities in Jordan as changing laws in a serendipity manner.

[9] Such an undertaking would require that the exact terms and conditions of the types of plans described in Section I be defined in terms of their operation, disclosure and tax ramifications, and then the applicable statutes be examined for wording preventing the enactment of such terms or the lack of wording authorizing it.

his plan within the safe harbor provisions, it would automatically be deemed approved. All plans designed within the terms approved by the government would be exempt from government review.

This approach is efficient because it only requires the government's reviewing authority to examine the terms of a proposed plan once. It would also bring closure to the question of what is acceptable and does not require each company to devote resources to gain approval of their proposed plans and the government to devote an equal amount of resources reviewing each one of them.

Factors which will have to be addressed and detailed solutions provided for and included in the requests for safe harbor provisions must include at least the following topics:

i) a description of the different types of plans under which stock will be transferred to employees;

ii) the terms and conditions of each of these plans;

iii) the vesting provisions of these plans;

iv) how and by whom the plans will be administered and who will bear the cost thereof;

v) a description of how and how often information about the plans and the employee's balances in the plans will be communicated to employees;

vi) a description of the dispute resolution procedure under which disputes between the company and participants are handled;

vii) the disclosure of the risks of the stock based on the terms of the plans such as vesting, repurchase liability, etc.[10]

viii) a company's estimated repurchase liability over time and how it will be addressed;

ix) how and how often the stock will be valued and by whom;

x) how liquidity will be provided to employee stockholders who want to sell their shares during their employment;

xi) what restrictions there will be on the shares of company stock and how will they be enforced;

xii) the tax ramifications for employees participating in the plans.

It is proposed that int@j undertake to obtain safe harbor provisions for Provident Funds, all other means of providing employer stock to employees, and legislative changes, in the immediate, short term and long term time frames, respectively.

Immediate action plans for Provident Funds: Jordanian labor law currently provides for a benefit plan entitled a "Provident Fund" which established by the employer for the

[10]This will not include form disclosure relating to the issuer/employer itself which will be unique for every company and is already covered by Articles 56 and 59 a of the Securities Law.

benefit of employees. The contributions to the fund are deductible for tax purposed for both the employer and employee[11].

The fund is funded by contributions from the employer and employees. The Provident funds are administered by trustees who are a group of employees selected for these positions. They have traditionally invested the funds in the stock of other publicly held companies and occasionally the employer.

These Provident Funds, if only slightly restructured, can have all the attributes of a traditional ESOP which provide broad based employee ownership through the company. Jordanian Tax law also provides an additional benefit not available in the US for ESOPs. A traditional ESOP is non contributory, i.e. the employee pays nothing into it. All of the contributions are paid by the employer.[12] And in the traditional ESOP there is no means for the employee to make any contributions to the ESOP even if the employee wanted to do so. As previously discussed, it is generally believed that stock purchased by an employee with their own funds will make the employees much more committed to being an employee owner and all the benefits which arise with that commitment.

The Provident fund, if modified only slightly, will present a vehicle for both broad based employee ownership and employee contributions. The modification would simply entail having the Fund invest solely (or primarily) in the employer's stock. Then, instead of making a contribution of cash to the fund periodically, the company/employer would contribute its own stock.[13] This raises the question of how much the employer could deduct for tax purposes for a contribution of its stock to the Fund.

Employees could also be allowed to make voluntary contributions to the fund for their own account which would in turn be used primarily or exclusively to purchase stock from the employer company.

Structuring and operating Provident Funds in this manner must be approved by the Minister of Labor to qualify for the preferential tax treatment.

It is proposed as an immediate means of providing employee ownership in the IT industry that a plan for a provincial Fund which incorporates all the features discussed above be drafted with all the ancillary documentation described on page 20 of this report and presented to the reviewing body, the Ministry of Labor, for approval. The plan would be promoted as the form for a new Provident Fund requested by the membership of int@j. The narrative description of how the proposed plan will operate and how it will benefit the industry would be presented by representatives of int@j. They would speak on behalf of the IT industry explaining all the benefits of the new plan.

Along with the int@j presenters should be the attorneys who would act as advocates to explain why the proposed plan is legal under the current law and advocating the

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[11] This is very similar to the 401(k) plans in the US.

[12] In a traditional ESOP, contribution are invested "primarily" in employer securities but not exclusively. A percentage is traditionally invested in their securities particularly on the accounts of older, risk adverse employees, to increase their diversification and decrease their overall portfolio risk. The amount of such diversification in the employees accounts, if any, is an issue for int@j to define and propose in their all encompassing plan.

[13] The taxing authority would have to address the propriety of taking a tax deduction based on the transfer of a company's own stock and the corresponding issue of how the stock is valued.

uncertainties including the deductibility of the value of the employer's contribution of its own stock to the plan.

The goal of this proposal would be to have the government approve a safe harbor plan concept and the ancillary documentation which could be adapted by members of the IT industry without any further action by the Ministry of Labor.

Keeping track of the periodic contributions to the accounts of all of all the company's employees, the balances in their accounts and the changes in value, can be an enormous task over time. The task cannot be done manually and must be set up on a computer based tracking system. It is impractical and unrealistic to expect each company adapting this new Provident fund program to develop their own software to account for this Fund. Therefore, administering these Funds should be done by one centralized organization which can develop[14] the software to perform this task and be outsourced the administration of all these companies' funds. It is proposed that int@j provide these services.[15]

It is believed that this proposal could be adapted quickly by the int@j membership and approved by the Minister of Labor without much effort or delay. According to the lawyers interviewed, none of what is being proposed violates any of the established laws so the approval should be obtained to clarify any uncertainties and establish a president.

Intermediate plan. In the intermediate term, a second more aggressive plan should be advanced in the same manner by int@j to obtain the approval of other mechanics of employee ownership such as stock options, stock bonuses, and individual stock sales to employees. This proposal is more aggressive because it could be argued that it contravenes Jordanian Law.[16]

In a manner similar to that proposed for the approval of the Provident Fund, it is recommended that int@j make a presentation to the Controller Of Companies who has authority over Limited Liability Companies, requesting that certain transactions and their ancillary documentation be approved which can then be used by the members of int@j on an ongoing, safe harbor basis.

This proposal would be for the approval of the issuance and exercise of stock options, stock purchase plans, and all the stock based incentive compensation plans which int@j wants to make available to its members for adaptation.[17]

The proposal to the controller of currencies should also include a request for approval of not only the transaction but also all the actions and documentation ancillary to this transaction. For example, in the transaction approval was for a stock option plan, int@j would request approval of

[14] This software can also be licensed from numerous providers in the US and UK.
[15] See Section I of this report for a description of this and other proposed actions for int@j.
[16] This conclusion is drawn from the fact that there is nothing in the Limited Liability Law which authorizes the use of such plans, and there are provisions in it which can be read to prohibit them.
[17] This presupposes that int@j first surveys its membership and comes to some consensus as to what types of benefit plans the membership wants to be able to implement, and also has answers to all the questions described on page 20 which must be presented to the Controller of Companies.

1. The written stock Option Plan (which would leave blank specific detail of the plan such as the number of shares it includes) to be approved by the company's General Assembly.
2. The form Option Agreement between the company and the individual employee which would describe exactly what is being given to the employee and the conditions (vesting) under which it is given.
3. The written material which would be given to employees describing their rights and obligations under the option plan.
4. All other documents reflecting the items on page 20 of this report.

The int@j presentation should be performed with their attorneys who would advocate the proprietary of these proposals and answer any legal questions of the Controller of Companies.

Once again, the goal of this action is to introduce these new concepts to the regulatory authorities and obtain their blanket approval for all similar plans implemented in the future.

Once this blanket approval is obtained, int@j could notify its members of this fact and provide them and their attorneys with the approved form of the transactions which could then be completed for each company wishing to adapt such an employee ownership incentive plan.

Long Term Plan: After the efforts described above are completed int@j will have a clear understanding of the official position of what can be accomplished under Jordan's law and what cannot. If after these efforts all or a majority of what int@j requests is approved, there may be no need for a any further legislative action. On the other hand if some of the key features of adapting employee ownership plans are authoritatively denied, int@j will have as its long term objective to change the legislation to allow the plans to be implemented.

Modifications to Securities Law of 1997: It appears from a reading of the Securities Law that most of the provisions are adequate to require adequate disclosure by stock issuing companies to their employees and to remedy any wrong resulting from a violation of these disclosure requirements.

Article 56 of the Security Law[18] provides a list of disclosures required to be made when a security is sold. Article 59 provides periodic information which must be filed with the Commission periodically.[19] The only recommend change to the securities laws is that one phrase be added to Article 59 which would require an issuer/seller of securities to provide information in its periodic filing of "All other information which a reasonable person would want to know prior to purchasing the security."

This phrase which is summarized from US/British Securities Laws requires the seller of securities to provide not just information listed in the other section of the status but also anything else which a reasonable person would want to know before purchasing the security. It does not specify exactly has to be provided because it is not possible to

[18] This Article is analogous to the US Securities Act of 1933.
[19] This Article is analogous to the US Securities and Exchange Act of 1934.

determine what would be material in different situations. The proposed definition places the burden on the issuer to determine what is material. And failure to provide this information is tantamount to intentional non-disclosure, otherwise know as “fraud.”

Under the current law there is no requirement that a seller of securities disclose in its periodic filings that he has just been released from prison after serving a 15 year sentence for securities fraud. Nor is there any specific requirement that the company disclose in its periodic filings that its main asset, a patent, is going to expire in six months and that their sales will thereafter expected to plummet. These are extreme examples but graphically depict the deficiency in the current law and how the suggested changed will improve upon it.

Conclusion: Employee ownership, when designed to be an integral part of a company's culture and rewards system, is a powerful tool for accessing the hearts and minds of employees. The challenge in Jordan lies in creatively structuring a legislative environment which will enable employee ownership to have the greatest desired impact on its IT industry and its employees.

APPENDICES

APPENDIX A

Presentation outlines of the August 1, 2000 presentation by Paul A. Kouris to stakeholders in the Jordanian IT Industry

COMMUNICATION REQUIREMENTS IN AN EMPLOYEE OWNED COMPANY

It has been said that the hardest part of establishing employee ownership within an organization is making the employees think like owners instead of employees through a system of education and communication to the employees which is designed to accomplish several objectives.

- First, the communications need to inform the employee about the EO system, what it is, how it operates, the benefits of being an owner, and the risks involved.

- Second, employee communications should inform members of their rights and obligations as employee owners.

- Third, communications are needed to inform employees of the status of the Operating Company, the ESOP, and their account including periodic updates of the operations of the Company and the ESOP.

Employees cannot be presented with information which is designed for other purposes. Reports need to be specifically prepared to give employees who are responsible for these duties information that will allow them do perform their job more effectively.

Employees need to be educated on how to interpret this information and use it to improve their performance and the performance of the company.

The fact that a business is employee owned, either wholly or partially, should be used as a marketing tool for the company. In the United States, employee owned companies advertise their employee ownership in their marketing campaigns. United Airlines, Avis Rent-A-Car and other ESOP owned companies all hold themselves out to the public as "Employee Owned."

Preparing communications

A statutory or regulatory requirement should be implemented mandating that certain communication be provided to ESOP members. The requirement should provide for at least three types of informational documents.

- The first type of document, which is traditionally called a Summary Plan Description, explains in easily understandable terms exactly what an ESOP is and the rights and obligations of the ESOP members.

- The second type of document which should be should mandated by law and provided to ESOP members are understandable financial statements and reports on the operations of the Company and the ESOP.

- The third and most important document which must be provided to ESOP members and required by law is a personal statement to the employee describing the employees holdings in the ESOP.

The ESOP/Company should also adapt a formal process to obtain continual feedback. A complete employee communications system must also provide for two way communications.

EMPLOYEE OWNERSHIP AND JUDICIAL ISSUES IN JORDANIAN IT INDUSTRY

by Paul A. Kouris, Esq.

of the Foundation for Enterprise Development

The place of Employee Ownership in Jordan

Designing and implementing laws to build an employee ownership culture

- Corporate Laws
- Securities Laws
- Labor Laws
- Tax Laws
- Means and procedures for enforcing the laws
- Designing, implementing and operating effective Dispute resolution Procedures

Learn from examples of other employee ownership structures around the world, both successful and otherwise.

Conclusion

CORPORATE LAWS

A. LAWS RELATING TO CORPORATE GOVERNANCE

Rights of Stockholders

- Electing board members by one vote per share/person
    - proxy information
        - disclosure of compensation and company performance
    - Employee and Outside Directors
    - Board Committees
- Voting on other matters relating to the company
    - major decisions
    - approval by quorum, majority, super majority vote
- Duties and obligation of board members
    - labor laws and securities laws
- Liabilities for breach of obligations

B. LAWS RELATING TO STOCK PROPERTIES

- Restrictions on stock
    - voting rights
    - transferability
        - right of first refusal
        - right of repurchase at termination
    - obligation to repurchase on termination
    - terms of repurchase liability
        - amount and timing
    - accounting for repurchase liability
        - estimating and funding the liability

THE PLACE OF EMPLOYEE OWNERSHIP IN IT BUSINESSES

The most critical step in designing an effective employee ownership program is to first define the company's/government's strategic objectives for equity sharing.

Employee ownership is a journey, not a destination.

A. Employee stock ownership works best when the following characteristics are present:

i. The leader articulates a clear vision for sharing equity.

ii. Employee ownership is designed to logically (and fairly) support the company goals and culture.

iii. Emphasis is placed on communications - about the company, the stock plan, the vision, mission and culture.

iv. Liquidity is provided within a reasonable time frame.

v. Employees are treated like owners - given responsibility, autonomy, and opportunities to offer feedback and ideas.

vi. Employee ownership is meaningful, not token.

vii. All employees are given the opportunity to own stock.

B. Two approaches for sharing ownership: performance based and broad based.

Performance based ownership plans.

- Stock options
- Stock Bonuses
- Direct Stock Purchase Offers

Broad Based Ownership Plans

- Stock Purchase Plans
- Qualified Retirement Plans
- Non-Leveraged Employee Stock Ownership Plans (ESOP)
- Leveraged Employee Stock Ownership Plans (ESOP)

LABOR LAWS

A. Employee ownership and unionization

Laws which effect the rights of employee/stockholders

B. Employee and Employer Contributions to Employer ownership plans

Employer contributions:

Good to put stock in the hands of employee but may be viewed as another entitlement.

Broad based.

Computed as a percentage of compensation with "top heavy" exclusion

Employee contributions of their own funds

Voluntary-where ownership mentality is believed-Used wisely and not excessively, allowing member to pay for employer securities is a viable strategy to promote the employee ownership within a company.

Mandatory- risky in the event of decreasing stock price

Employee contributions can be encouraged/supplemented by tax incentives

The concept of making individual members contribute to the ESOP is, in itself, justifiable. Studies have shown that employees who contribute their own funds to acquire their interest are more inclined to act like owners. Employees who invest in employer stock do not look upon their investment as just another entitlement of working. They view it as something they worked and paid for. As a result, they are less likely to use it as a source of short term funds. Instead, employees who purchase their interest in their employer will hold on to these interest for the duration of their employment. For example, it has been demonstrated that almost 90% of employees of publicly held companies who receive stock options, exercise those options and sell the underlying stock in the same transaction on the same day. As a result, these employees lose their stake in their employer after the excise of their options.

Requiring employee contributions is very popular in many direct stock ownership plans for this reason. Two examples are 401(k) plans and stock purchase plans. In the 401(k) plan , employees make pretax contributions to a fund which can then be matched by contributions from the employer. The employee can then purchase employer stock or other securities with the total invested in this fund. Another example is an employee stock purchase plan which provides that the employee have a certain percentage of his earnings withheld from each paycheck and then periodically used to purchase employer securities, usually at a discount.

SECURITIES LAWS

A. Scope of Securities laws- relate to the transfer of securities, i.e., stock and financial instruments

Imposes a regulatory system for the sale and transfer of securities

B. Principles underling securities laws

1. The sale of securities is a privilege and not a right which the government can regulate.

The privilege to sell securities as a broker/dealer requires passing a rigorous testing/qualifications and licensing by the government

2. The transfer of securities must be accompanied by complete full and fair disclosure.

Full disclosure requires everything unfavorable about the security and the seller be disclosed.

Disclosure must be made by both issuer and seller

Disclosure of tax and vesting provisions

Financial reporting-

approval by outside auditor

Disclosure of information must be periodic and timely

3. Conflict of full disclosure requires release of private information.

C. Valuing securities:

1. Securities valuation is the foundation of an employee ownership system

2. The valuation system must be fair, objective, consistently applied, and fully disclosed.

Cannot be used to raise, lower, or even out the price of the shares

3. Valuation subject to frequent abuse

The value of the shares should be based on generally accepted valuation principles. If the company stock is actively traded on the stock exchange, the value of the shares in should be based on the closing price as reported in the market on that date. All transactions dealing with the shares, allocations, participant statements and distributions should be based on this price.

If the stock is not traded on the stock exchange or thinly traded, generally accepted valuation methods should be used to determine value. This includes techniques using discounted cash flow, liquidity value and use of financial ratio comparisons with similar company’s whose stocks are traded on the stock exchange. This annual valuation should be reviewed and approved by an independent third party with expertise in valuation methodology.

RECOMMENDED TAX INCENTIVES TO ENCOURAGE EMPLOYEE OWNERSHIP

Tax incentives, when properly established, can help the government promote the use of employee ownership, give employee a long-term focus on the company, encourage the private sector to get involved and provide positive cash flow impact on the companies establishing employee ownership. The following tax incentives be analyzed in greater detail to determine its fiscal impact on the Government.

1) Tax deduction on dividends paid to the ESOP.

2) Tax deduction on contributions made by employees to the ESOP.

3) Tax incentives for private sector loans to ESOPs.

4) ESOPs a tax-free entity.

5) Tax employee payments from ESOP if distributed prior to retirement age.

6) Allow for tax free/deferred exercise of stock options.

7) Allow employees to make tax deferred contributions to their own retirement account and invest those assets in company stock.

8) Tax free/deferred discounts on stock purchases.

9) Assess an additional tax is benefits are utilized prior to retirement except in "hardship cases."

10) Establish a preferred tax rate on the sale of stock held for long periods (i.e.. capital gains tax rate).

MEANS AND PROCURES OF ENFORCING LAWS

I. Who can enforce a law:

- Government and Private Rights Of Action
  - Remedies-
    - Injunctive
    - Civil
      - treble damages and fines
      - personal liability

II. Designing, Implementing, and Operating an effecting Dispute Resolution procedure

- Courts
- Alternative Dispute Resolution
  - Mediation
  - Arbitration
    - Benefits
      - Speed-Actions progress quickly because of vast numbers of potential arbitrators
      - Cost- not expensive because of expedited process
      - Simplicity-arbitrators act based on fairness.

    Typical format of arbitration is three <u>independent</u> arbitrators approved by both sides, two with industry experience and one lay person, majority rules.

  Popular in America especially in securities matters where it is mandatory.

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The ESOP/Company should also adapt a formal process to obtain continual feedback. A complete employee communications system must also provide for two way communications.

CONCLUSION

1. Ownership programs and the laws which support them must evolve with the changing needs of the business environment.

2. Employee ownership must be broad based to work.

3. Education through information dissemination is the key for employees to value ownership and act like owners.

4. The employee ownership system must be viewed almost as a religion for it to succeed.

For addition information, resources, literature e mail me;

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APPENDIX B

Employee Ownership Incentives:

A Brief Survey of International Practice

CHILE - Chile developed a strategy for "labor capitalism" in order to build support for its privatization program. As a general rule, workers were offered 5-10% of a privatized company's shares at a discount price. To pay for the shares workers were allowed borrow up to 50% of their severance pay, with the company promising to repurchase the shares at retirement at a value at least equal to the foregone severance payments. Thus, employees could buy shares at below market price with no cash outlay, with no risk of loss, and a potential for gain if the shares increased in value. This scheme proved to be quite attractive and approximately 15 privatized companies ended up with significant levels of employee ownership.

CHINA - Though the word "privatization" is not acceptable to the Chinese government, they have nevertheless introduced experiments in "social ownership" whereby workers in large factories can receive stock ownership in their companies. More significantly, many of the village enterprises have been turned over to the local communities in which ownership is shared broadly among both the workers and the local citizens.

CZECH REPUBLIC - The Czech concept of privatization is based on citizen vouchers. Each citizen over the age of 18 was given the opportunity to purchase vouchers and use these vouchers to buy shares in approved companies. Employee Ownership was limited to 10% of a privatized company where employees are given no additional incentives to purchase stock. In most cases the employees received little or no ownership in the privatized company.

GERMANY - By law all government owned companies in Eastern Germany must be privatized. The main techniques for privatization are sale to foreign companies, liquidation and management buyouts. Management buyouts occurred mainly in service industries and in small and mid-sized companies. 60% of management buyouts include public financing and approximately 10% include broad-based employee ownership. The method and amount of employee ownership is not stipulated in the privatization laws.

HUNGARY - The Hungarian privatization legislation gave strong preference to the use of leveraged ESOPs based on the US. and UK. models. Employee groups that organize themselves into ESOP companies are allowed to purchase a company's shares with payments spread over a 15-year period, with an optional 3-year grace period of interest payments only. The interest rate is 3% plus the intermediary bank's 4% margin. Banks may lend up to 85% of the value of the shares. A required down payment of 2%, 15% or 25% is based on a formula linked to the average price per participant for those shares proposed for ESOP financing. ESOP companies qualify for a tax deduction for up to 20% of their pre-tax profits to fund an ESOP or to repay ESOP-related privatization debt. In addition, dividends are deductible by the corporation, if the dividends are applied to debt repayment. ESOPs have played a significant role in approximately 150 privatization transactions.

JAMAICA - Jamaica's privatization program includes a comprehensive set of incentives for employee ownership in both private and privatizable companies. Employees are eligible for a tax deferral on shares allocated to their ESOP accounts, a tax exemption on personal funds used to acquire shares, and a personal tax deduction for 25% of the principal and 100% of the interest for servicing a loan used to acquire shares. Dividends received on ESOP-held shares are exempt from tax. Shares held in an ESOP for more than six years are received tax free. Corporations can claim a tax deductions of varying amounts to facilitate employee acquisition of ESOP shares, and lenders are allowed a tax exemption on 50% of the interest earned on ESOP loans, increasing to 100% for loan that result in an ESOP acquiring 15% or more of a company's shares.

POLAND - For larger companies slated for privatization, employees are limited to a maximum ownership stake of 20%, with the shares offered at a 50% discount. National mutual funds acquire the remaining shares. For smaller firms, however, a "liquidation" option enables employee groups to structure a management-employee lease-buyout if at least 50% of the employees agree to participate. This has proven to be the most popular and most successful form of privatization and has resulted over 1,000 new employee owned companies

RUSSIA - On paper, Russia can claim to have one of the largest number of employee owned companies in the world. Of the approximately 12,000 medium and large scale enterprises privatized after 1992, about two-thirds were majority owned by their employees following privatization. Workers were given some shares for free and were provided significant purchase discounts. Managers were also allowed to purchase shares prior to any shares being sold to the public. Russian citizens at large were granted privatization vouchers to invest in privatizing companies and many employees used their vouchers to purchase additional shares in their own companies. Following the first round of privatization the level of employee ownership has been falling rapidly as employees are beginning to sell their shares to outside investors.

SLOVAKIA - Privatization is based on public auctions and direct sales. Employee participation in ownership takes two forms. Employees can buy shares in their own company on favorable terms requiring a 10 - 15% deposit with 10 - 15 year repayment terms at low interest rates or through management buyouts whereby management gets no special incentives.

SLOVENIA - Most management-employee buyouts in Slovenia are structured with the assistance of a holding company which acts as the seller. Typically, the state company transfers assets into one or more new companies and becomes the holding company with 100% ownership of the subsidiaries. The state-owned company then sells shares on favorable terms to employees, providing long-term financing. The privatization transactions typically combine a free transfer of up to 20% of the shares to employees at no charge, 20% is distributed to investment funds owned by citizens at large, 10% to the national pension fund and 10% to the national compensation fund. The remaining 40% is sold either to employee groups or sold in a public tender or auction, or in a public offering of shares.

UNITED KINGDOM - The laws in the UK. have been adapted to accommodate the use of leveraged ESOPs similar to the United States. Leveraged ESOPs have played a significant role in privatization transactions as well as in private transactions among UK. companies. Under Margaret Thatcher, the UK. government's privatization program included a goal of providing employees of privatized companies opportunities to purchase discounted shares. The success of this program was a key to building political support for privatization and contributed in large measure to the government's claim to have quadrupled the number of shareholders in the country. Today several hundred UK. companies have substantial levels of employee ownership. Employees in privatization transactions were typically offered some free shares (subject to a 2-year holding requirement), priority in the allocation of shares, a discount of 10% on share purchases, and the opportunity to buy shares on a matching basis (buy one, get one for free). Tax incentives to encourage the development of employee ownership include a corporate tax deduction for principal and interest payments on ESOP loans and a deferral of capital gains taxes for sales of stock to ESOPs in privately-held companies if the ESOP owns a minimum of 10% of the company stock.

UNITED STATES - Today in the United States upwards of 15,000 companies have some amount of broad-based employee ownership. The aggregate value of employee holdings is estimated to be in the range of $300-400 billion, or approximately 7% of the market capitalization of US. companies. The most typical form of employee ownership is an employee stock ownership plan, or ESOP, but a variety of other mechanisms such as retirement plan investments in employer securities, stock purchase plans, stock bonuses and stock options made available to a broad cross-section of employees are frequently used. A growing number of multinational companies are now beginning to offer shares to their international employees as well.

A unique feature of US. employee ownership law is the use of leveraged ESOPs to allow employees to purchase shares on credit, using the credit capacity of the company itself to secure the loan which is then repaid out of future corporate cash flows. This enables employees to obtain larger blocks of shares than they would otherwise be able to purchase on their own and has resulted in ESOPs playing a significant role in corporate restructuring and ownership transition strategies. To encourage the growth of ESOPs, the US. Congress has granted ESOPs important tax advantages. These include a corporate tax deduction for the principal and interest payments on ESOP loans, a corporate tax deduction for dividends paid on ESOP shares, a deferral of capital gains taxes for individuals selling shares to an ESOP in a non-publicly-traded company (if the ESOP ends up with a minimum of 30% of the shares), and an exemption from taxes of 50% of the income earned on loans to ESOPs (subsequently repealed).

In addition, in the United States many companies are using employee ownership techniques to help them meet various business objectives including the recruiting and retention of key employees and the use of stock as a form of compensation. In many cases these employee ownership programs are used for a limited number of employees instead of broad - based use.